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C O N F I D E N T I A L SECTION 1 OF 2 LISBON 21

E.O. 11652: GDS

TAGS: ECON, PO

SUBJ: STUDY OF PORTUGAL'S ECONOMIC PROBLEMS

REF: LISBON 5351

SUMMARY: IN A RECENT STUDY THE SWEDISH ECONOMIST ERIK LUNDBERG SUCCINCTLY IDENTIFIES DANGER AREAS IN PORTUGAL'S CURRENT ECONOMIC SITUATION AND SUGGESTS POLICIES THE GOP COULD EMPLOY TO MINIMIZE THEM. EXPRESSING FAITH IN PORTUGAL'S DEVELOPMENT POSSIBILITIES AND CONTRASTING ITS 1974 PERFORMANCE FAVORABLY WITH OTHER OECD COUNTRIES (E.G., MORE GROWTH, LESS UNEMPLOYMENT), HE SEES THE MAIN DANGERS AS INCIPIENT RATHER THAN FULL-FLEDGED--AS CONDITIONS THAT WILL BECOME SERIOUS IF NOT GIVEN IMMEDIATE ATTENTION. HIS BASIC RECOMMENDATION FOR ACHIEVING STABILITY IS AVOIDANCE OF RADICAL CHANGE AND CONCENTRATION OVER THE NEXT THREE TO FOUR YEARS ON MAKING THE EXISTING ECONOMIC STRUCTURE WORK AS EFFICIENTLY AS POSSIBLE. A SINE QUA NON FOR SUCH A POLICY IS REESTABLISHMENT OF THE PRIVATE SECTOR'S CONFIDENCE. THE IMPORTANCE OF LUNDBERG'S PAPER LIES IN THE

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FACT THAT IT SYNTHESIZES VIEWS HELD BY MANY OF THE GOVERNMENT'S

ECONOMISTS AND CONTAINS RECOMMENDATIONS THAT HAVE ALREADY INFLUENCED PORTUGUESE DECISION MAKERS. END SUMMARY.

1. ENLISTED BY MINISTER OF FINANCE SILVA LOPES, ERIK LUNDBERG, A SWEDISH ECONOMIST, HAS IDENTIFIED PORTUGAL'S CURRENT ECONOMIC PROBLEMS IN A 16-PAGE, STILL UNPUBLISHED PAPER, A COPY OF WHICH THE MINISTER HAS NOW PROVIDED US. WHILE THE DOCUMENT IS DATED DECEMBER 4, IDEAS EXPRESSED IN IT WERE AVAILABLE TO THE GOP EARLIER. THE PAPER, WHOSE SUBSTANCE IS SUMMARIZED BELOW, OFFERS POLICY GUIDANCE AS WELL AS PROBLEM IDENTIFICATION.

2. ALTHOUGH DEPLORING THE GREAT LACK OF STATISTICAL DATA AND THE DIFFICULTY THIS CREATES FOR ANALYSIS AND DECISION MAKING, LUNDBERG FINDS ENOUGH EVIDENCE TO GENERATE CONFIDENCE IN THE "POSITIVE DEVELOPMENT POSSIBILITIES" OF THE PORTUGUESE ECONOMY AND TO CHARACTERIZE ITS 1974 PERFORMANCE AS GENERALLY BETTER THAN OTHER OECD COUNTRIES NOW BESET WITH RECESSION. HIS THESIS, HOWEVER, IS THAT THE GOVERNMENT RUNS GREAT RISKS OF RAPIDLY WORSENING CONDITIONS IF ITS DOES NOT CHANGE AND IMPROVE ITS ECONOMIC POLICIES QUICKLY. LUNDBERG IDENTIFIES THE DANGER AREAS AS RAPIDLY INCREASING UNEMPLOYMENT, DECLINING INVESTMENT, DEFICIENT SAVINGS, A GROWING DEFICIT IN THE BALANCE OF PAYMENTS, AN UNSTABLE FINANCIAL AND CREDIT SYSTEM, AND EXCESSIVE INFLATION. SEEN AS AGGRAVATING THE RISKS ARE THE INADEQUATE ECONOMIC STRUCTURE OF THE WHOLE PORTUGUESE ECONOMY AND THE LACK OF CONFIDENCE BETWEEN THE GOVERNMENT AND THE BUSINESS COMMUNITIES.

3. RECOGNIZING THAT POLICIES DESIGNED TO MINIMIZE ALL OF THE ABOVE ENUMERATED RISKS WOULD CONFLICT AND THAT PORTUGAL CANNOT ENTIRELY AVOID THE CONSEQUENCES OF THE INTERNATIONAL RECESSION WHICH HE EXPECTS TO PERSIST THROUGH MID-1976, LUNDBERG ASSERTS THE NEED TO ESTABLISH PRIORITIES. IN HIS VIEW THE NUMBER ONE AIM SHOULD BE "HIGH EMPLOYMENT AND LOW UNEMPLOYMENT," WHICH CAN BE ACHIEVED ONLY AT THE COST OF CONSIDERABLE LOSS IN EXCHANGE RESERVES AND BORROWING FROM ABROAD. LUNDBERG'S FUNDAMENTAL ADVICE FOR ACHIEVING THE EMPLOYMENT OBJECTIVE, AND STABILITY GENERALLY, IS TO AVOID RADICAL CHANGES IN THE EXISTING ECONOMIC STRUCTURE OVER THE NEXT THREE TO FOUR YEARS AND TO CONCENTRATE ON IMPROVING ITS EFFICIENCY. COUPLED WITH THIS ADVICE IS LUNDBERG'S "KEY CONCEPT" THAT THE GOVERNMENT MUST RE-

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ESTABLISH THE CONFIDENCE OF THE PRIVATE SECTOR. TOWARD THIS END HE RECOMMENDS A DECLARATION IN THE FORM OF SHORT-TERM PLANS FOR OPERATING THE ECONOMY, IN EFFECT ESTABLISHING THE "RULES OF THE GAME" FOR PRIVATE ENTERPRISES. AS A SIGNAL, HE SUGGESTS THE REOPENING OF THE STOCK EXCHANGE.

4. SPECIFIC RECOMMENDATIONS FOR QUICKLY ADOPTED POLICY CHANGES TO PROMOTE STABILIZATION-LUNDBERG IS PARTICULARLY CONCERNED

THAT THE CURRENT HIGH RATE OF INFLATION BE REDUCED--ARE PRESENTED UNDER AN UMBRELLA HE LABELS A "DECLARED PRICE-INCOME POLICY", A KIND OF "SOCIAL CONTRACT," WHICH EMBRACES THE FOLLOWING:

A. STABILIZATION OF WAGE COSTS-HAVING LITTLE CONFIDENCE IN RESTRICTIVE MONETARY AND FISCAL POLICIES, LUNDBERG SEES WAGE-COST STABILIZATION, USING INDEXED COLLECTIVE AGREEMENTS OF AT LEAST ONE YEAR, AS THE "NECESSARY CONDITION" FOR DAMPENING INFLATION.

B. DISTRIBUTION OF GNP-AN INCREASING SHARE OF GNP GROWTH SHOULD BE USED FOR INVESTMENT AND EXPANSION OF THE PUBLIC SECTOR. REAL WAGES OF THE LOWEST INCOME GROUPS SHOULD BE INCREASED AND THOSE OF HIGHER INCOME GROUPS SHOULD RECEIVE A "TOLERABLE REDUCTION."

C. RESTORATION OF VIABILITY OF PRICE-COST SYSTEM-THERE SHOULD BE A ONE-TIME ADJUSTMENT OF PRICE POSITIONS DISTORTED BECAUSE OF PRICE CONTROL MEASURES AND SUBSIDIES. SUBSIDIES SHOULD BE ELIMINATED, BUT PRICE CONTROL OF STANDARD GOODS AND CLOSE SUPERVISION OF GENERAL PRICE DEVELOPMENT SHOULD BE CONTINUED. REASONABLE PROFIT MARGINS SHOULD BE RESTORED.

D. EXPANSIVE CREDIT AND FISCAL POLICIES-WHILE CONCEDING THAT THE RIGHT DEGREE OF EXPANSION IS DIFFICULT TO DETERMINE, HE BELIEVES THAT THE GOP SHOULD ERR ON THE SIDE OF TOO MUCH RATHER THAN TOO LITTLE. MONETARY AND FISCAL POLICIES, HE SAYS, MUST BE BETTER COORDINATED. PRIVATE SAVINGS, INCLUDING EMIGRANT REMITTANCES, SHOULD BE STIMULATED BY HIGHER INTEREST RATES AND INDEXED DEPOSITS AND LOANS. THE ONLY DIRECT EXPANSIONARY ACTIVITY HE RECOMMENDS FOR THE GOVERNMENT IS CONFIDENTIAL

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5. WHILE LUNDBERG REFRAINS FROM MAKING POLICY RECOMMENDATIONS FOR THE LONG TERM, HIS LISTING OF "GREAT STRUCTURAL PROBLEMS" ARE A USEFUL REMINDER THAT SUCH PROBLEM EXIST: TREMENDOUS WAGE AND SALARY DIFFERENTIALS WITH AN EVENING OUT PROCESS MADE DIFFICULT BY THE TRADE UNION STRUCTURE; WIDE DIFFERENCES IN PRODUCTIVITY BETWEEN PLANTS, REGIONS, AND BRANCHES; EXTENSIVE CONCEALED UNEMPLOYMENT; DIVISION OF THE PRIVATE SECTOR INTO MANY BACKWARD SMALL AND MEDIUM-SIZED PLANTS AND FEW LARGE MODERN PLANTS, WITH A PREVAILING CONSERVATISM THAT ENGENDERS SUSPICION AND RESISTANCE TO FORWARD-LOOKING GOVERNMENT POLICIES; AND INERTIA AND INFLEXIBILITY IN THE PUBLIC SECTOR. MANAGEMENT TALENT, LUNDBERG ACCURATELY OBSERVES, IS THE SCARCE FACTOR TO BE MOBILIZED IN BOTH THE PRIVATE AND GOVERNMENT SECTORS. HE NOTED, HOWEVER, THAT A GOOD ASPECT OF THIS GENERAL BACKWARDNESS IS THE FACT THAT IT BETOKENS AMPLE ROOM FOR GROWTH AND PRODUCTIVITY GAINS AND A BIG RESERVE OF USEFUL PROJECTS NEEDED FOR LONG-TERM ECONOMIC GROWTH.

6. LUNDBERG DEVOTES A SECTION OF HIS PAPER TO STATISTICAL PROBLEMS IN WHICH HE DEPLORES HE GENERAL LACK OF
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RELIABLE STATISTICS, WHICH MEANS THAT THE STATISTICAL BASIS FOR POLICY DECISIONS IS "ABNORMALLY WEAK." AMONG THE MORE INTERESTING OF LUNDBERG'S STATISTICAL "GUESSTIMATES" ARE THE FOLLOWING: 2 TO 3 PER CENT GROWTH OF GNP IN 1974; 5 PER CENT INCREASE IN 1974 REAL WAGES; BIG DECLINE IN PRIVATE SECTOR SAVINGS (DOLS 1 BILLION); AND 10 TO 15 PER CENT DETERIORATION IN TERMS OF TRADE.

7. COMMENT:

A. THE LUNDBERG PAPER IS OF MORE THAN PASSING IMPORTANCE BECAUSE IT REFLECTS THE VIEWS OF LEADING ECONOMIC OFFICIALS, AND EVIDENCE SUGGESTS THAT IT HAS EXERTED CONSIDERABLE INFLUENCE ON GOP DECISION MAKERS. THE MODERATION HE ADVOCATES-- I.E., EMPHASIS ON PERFECTING THE EXISTING SYSTEM, INCLUDING MAINTENANCE OF AND SUPPORT FOR THE LARGE PRIVATE SECTOR---IS EVIDENT IN THE VIEWS HELD BY MINISTER OF ECONOMY VILAR (SEE REFTEL) AND MINISTER OF FINANCE SILVA LOPES AND THE MEN THEY HAVE AROUND THEM. THESE AND OTHER OFFICIALS USE LUNDBERG'S TERMINOLOGY IN STRESSING THE IMPORTANCE OF ESTABLISHING "THE RULES OF THE GAME" FOR THE PRIVATE SECTOR. BY DRAFTING AN INTERIM ECONOMIC PLAN, WHOSE PARTICIPATION IS EXPECTED SOON, THE GOVERNMENT IS FULFILLING LUNDBERG'S RECOMMENDATION FOR A "SHORT TERM PLAN". FURTHERMORE, IT HAS GIVEN THE SIGNAL TO THE PRIVATE SECTOR SUGGESTED BY LUNDBERG; IE., THE ANNOUNCEMENT WAS RECENTLY MADE THAT THE STOCK MARKET WOULD REOPEN IN EARLY 1975.

B. ECONOMIC DEBATE WITHIN THE GOP NOW CENTERS ON HOW MUCH AND HOW FAST THE ECONOMIC SYSTEM SHOULD BE CHANGED. THE LUNDBERG PAPER CLEARLY GIVES THE MODERATES GOOD AMMUNITION TO SUPPORT THIER CASE. THE EXTENT TO WHICH THEY HAVE PREVAILED SHOULD SOON BE EVIDENT WITH THE PUBLICATION OF THE INTERIM ECONOMIC PLAN MENTIONED ABOVE.
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